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TITLE

Whether the Armenian BIT Network Provides For a Proper Protection to Foreign Investments in Case of Possible Political Changes?

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Introduction

Political changes are interpreted as a political risk because of which an investment's returns may suffer.[1] In developing countries, the increase of foreign direct investment is connected with the factors of economic and political changes.[2] Instability stems from a change in government, legislative bodies, other foreign policymakers or military control which are affecting on investment returns.[3] The instability of political and military-political field entails to the fall of the state's rating in the international arena which negatively affects the development of the economy and the investment process. Therefore, it is essential to create a stable atmosphere for foreign investments, as the capital stream to the low-risk political environment with foreseeable government behavior, stable and favorable legal framework, fiscal and monetary policy.

Political risks associated with political change are miscellaneous. Countries with a high degree of political instability, generally exhibit high rates of expropriation of assets and this entails to less attractiveness of the investment.[4] International investors usually face this, when the current Government changes its attitude toward foreign investment or a new Government comes to power.[5]

While governments are improving their legal framework in the international investment law sphere, Bilateral Investment Treaties (hereinafter: BIT) provide guarantees for the investors of one contracting state investing in the other contracting state. Our topic will discuss investment protection in BIT level, as BITs reduce political risks and promote foreign investments. Currently, Armenia is a member of 42 bilateral investment treaties that provide protection for foreign investments.

The characteristic of Foreign Direct Investment (hereinafter: FDI) is that after an investment has been made, a foreign investor becomes vulnerable of possible actions of the host country's

[1] *Available* at: https://www.investopedia.com/terms/p/politicalrisk.asp

[2] Zaqaryan H., *Foreign Direct Investments in Armenia*; 21th Century, number 4 (80), (2018): available at http://noravank.am/upload/pdf/Hamlet_Zakaryan_21DAR_04_2018.pdf

[3] *Available* at: https://www.investopedia.com/terms/p/politicalrisk.asp

[4] Azzimonti M at al., *Barriers to Foreign Direct Investment Under Political Instability*, Economic Quarterly; volume 93, Number 3 (2007), p. 288

[5] Wagner D., *The Impact of Political Change and How To Protect Your Business Against It*, (2000) *available at:* https://www.irmi.com/articles/expert-commentary/the-impact-of-political-change-and-how-to-protect-your-business-against-it

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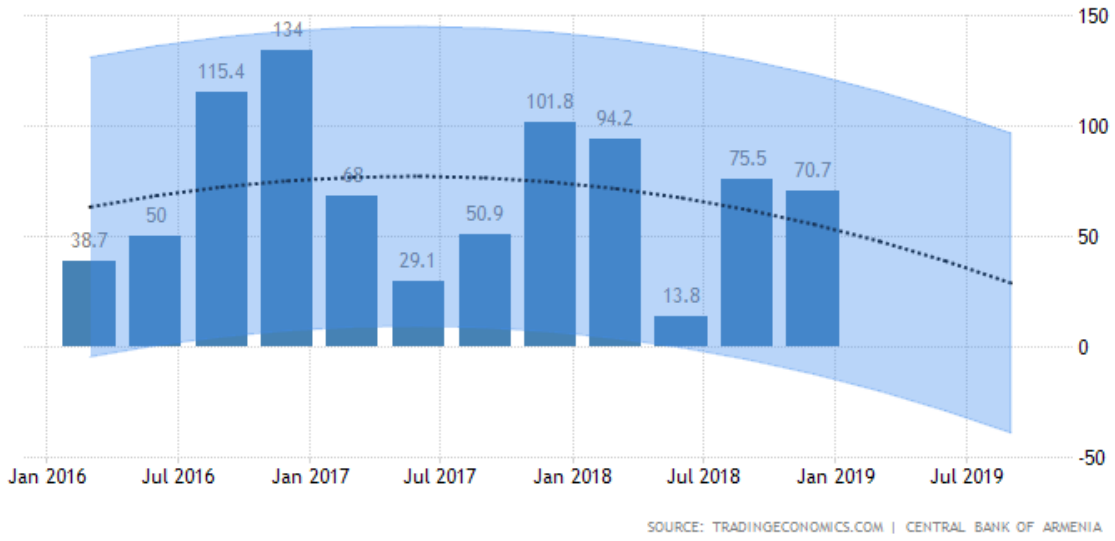
government and is not protected from the environmental changes other which the investment decision was made.[6]

One of the main political risks, which emerge for the international investor, is the alteration of the host government's position that would change the balance of burdens, risks, benefits, which the Contracting sides laid down when they negotiated the deal and which played the significant ground for the investor's business plan. Legitimate expectation expressed in the plan is also worthy to take into account. Alteration of position on the part of the host country becomes more probable with every subsequent change of government of the host state during the period of the investment.[7]



[8]

As we can see in the forecast data presented in the above diagram, after the last political changes in 2018 in Armenia, there is going to be an appreciable reduction of FDI in the coming years. In our point of view, after the last political events have taken place in Armenia, an increase of political risk and instability is noticeable. So it is obvious that these events will have a huge negative effect on FDI and will become an obstacle for FDI inflows.

Taking into account the importance of increasing the attraction level of investment in Armenia after the latest event and minimizing risks for foreign investments during political changes, as stated above, the purpose of this paper is to answer the following question: whether

[6] Azzimonti M at al., *Barriers to Foreign Direct Investment Under Political Instability*, Economic Quarterly, volume 93, Number 3 (2007), p. 287

[7] *Ibid.*

[8] *Available at*: https://tradingeconomics.com/armenia/foreign-direct-investment

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Armenian BIT network provides for proper protection to foreign investments in case of possible political changes.

In order to answer the research question, first of all, the general picture concerning the protection of foreign investments will be presented in the scope of political changes. Afterward, specific commonly used Armenian BITs will be thoroughly analyzed and compared with international practice.

The works of Rudolf Dozer, Stephan W. Schell, Stephan Kinsella, and relevant ICSID cases will be examined, as well as the Canada-Armenia BIT, UK-Armenia BIT, because these treaties involve strong instruments offering broad protection to entities conducting business in the territories of contracting parties. After the analysis, the conclusion will be presented whether the Armenian BIT network provides for proper protection to foreign investments in case of possible political changes or not.

Analytical discussion, using the method of documentary analysis, will be held on the advantages and deficiencies in the regulation and practice trying to suggest possible solutions to the problems.

This paper consists of an introduction, three chapters, conclusion, and bibliography. This introduction briefly introduces the possible political changes and their effect on foreign investments, as well as describes the need for foreign investment proper protection. The first chapter will study the state's right to regulate– the doctrine of public policy, and the legitimate expectations of the investors, an application of legitimate expectations in case of political changes.

The second chapter will analyze the foreign investment protection standards under the Canada-Armenia BIT and the UK-Armenia BIT in case of political changes. The practice under the selected BITs will be analyzed in parallel with international practice. This chapter will also include a detailed analysis of the famous Lydian case. Such structured analysis will ultimately lead to a comprehensive answer to the research question.

The third chapter will answer the research question of whether or not the selected Armenian BITs provide proper protection for foreign investments in the scope of political changes. It will highlight the main outcomes of the research and bring some recommendations for tackling the problems in the Armenian BIT network.

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CHAPTER 1

STATE'S RIGHT TO REGULATE AND LEGITIMATE EXPECTATION DOCTRINE

§ State's right to regulate – the doctrine of public policy

States limit their sovereignty by entering into every international agreement. States restrict themselves with the possibility of investor-state settlement and arbitration through various multilateral free trade agreements (FTAs), such as the North American Free Trade Agreement (NAFTA), bilateral investment treaties (BITs), and bilateral trade treaties.[9]The aim of this is to provide foreign investor confidence by limiting the sovereignty rights of the State and the powers of its domestic legal system.[10]

State's right to regulate (also known as "State police powers doctrine") is the legal right allowing the host State to derogate from international commitments it has undertaken by investment agreement. It happens when a state has vital importance interests of the population involved.[11] State's right to regulate is a states' sovereign right to regulate for the public interest—in other words, their policy space. The balance between the protection of the state's interests through governmental action and the level of the interference to the investor's rights being affected of the above-mentioned actions is interpreted under the light of the principle of proportionality.[12] How to achieve a balance between the foreign investors' adequate protection and the host countries' need to preserve sufficient regulatory space, is a strategic choice and depends on individual country preferences and policies. [13]

In recent years, the concept of balancing the protection of international investors and the host State's right to regulate have started to form. Investing in the state an investor has the expectation of stable and reliable legal environment of the host State. Along with the regulation changes, investors can claim breach of treaty protection, as the actions affect the investment and

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[9] Giest A., *Interpreting Public Interest Provisions in International Investment Treaties*; Chicago Journal of International Law Volume 18 | Number 1; Article 9 (2017)

[10] Dolzer R., *The Impact of International Investment Treaties on Domestic Administrative Law*; 37 NYU Journal of International Law and Politics (2005)

[11] Zarra G., *Right to regulate, Margin of Appreciation and Proportionality:* Arbitration in Light of Philip Morris v. Uruguay

[12] *Ibid*.

[13]World Investment Report 2015: *Reforming International Investment Governance*; New York and Geneva, (2015)

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there emerges a violation of investor's legitimate expectation. To refrain from such a situation, there should be established a balance between State's right to regulate and investors' alleged violation of legitimate expectations resulting in economic loss.[14]

In InterAgua v Argentina ICSID Case No. ARB/03/17 the Tribunal stated that:

"States have a reasonable right to regulate foreign investments in their territories even if such regulation affects investor property rights. In effect, the [police powers] doctrine seeks to strike a balance between states right to regulate and the property rights of foreign investors in their territory.'[15]

However, judge Gary Born expressed dissenting opinion stating that undertaken measures were lacking proportionality. "States' sovereignty is certainly an element to be taken into account when evaluating whether a state measure is proportional to its goals, but it is not the only element."[16]

One of the clearest examples of giving significance to the state's reason to regulate reflects *Philip Morris v. Uruguay* case where Tribunal found that:

"Responsibility for public health measures rests with the government and investment tribunals should pay great deference to government judgments of national needs in matters such as the protection of public health. In such cases respect is due to the discretionary exercise of sovereign power, not made irrationally and not exercised in bad faith [...] involving many complex factors"[17]

It is worth to notice that the new regime, that comes and effects on the foreign investments established during the old regime, is the successor of the old ones. That means that all the rights and obligations are being transferred to the new regime. The foreign investor can find protection under this regulation. The new Government decisions to cease or to change the conditions of the foreign investment, which will entail to the loss of investment, will be compensated the same way as it would have taken place during the old regime. That is why the foreign investor can freely enjoy the protection covered by BITs.

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[14] Gaukrodger D., *The Balance Between Investor Protection And The Right To Regulate In Investment Treaties: A Scoping Paper*; OECD Working Papers on International Investment (2017),

[15] *InterAgua v Argentina,* ICSID Case No. ARB/03/17, Decision on Liability, 30 July 2010, at paragraph 147–48:

[16] Zarra G., *Right to regulate, Margin of Appreciation and Proportionality*: Arbitration in Light of Philip Morris v. Uruguay

[17] *Philip Morris Brands Sàrl, Philip Morris Products S.A. and Abal Hermanos S.A. v. the Oriental Republic of Uruguay, ICSID Case No. ARB/10/7*

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In 2018, there were political changes in Armenia. The exploitation of Amulsar mine, which was prepared for operation about 10 years, temporarily ceased. The new prime minister of Armenia made a statement concerning this case: 'it is essential to clarify two questions: the first one relates to the safety of Sevan and Jermuk waters and the second to drainage basin in general'. He also stated that the exploitation of the mine will be prevented if it appears that there is a danger arisen from the exploitation of the mine. As we can conclude from the facts, here is a scenario where the Government uses its right to regulate and applies its sovereign rights, nevertheless trying not to ignore the measures of proportionality.

In our point of view, every State should firstly, evaluate the facts, before making a decision concerning foreign investments. The long economic interest of the State, which is the long economic interest of the State's whole population, should be put into comparison with the private community's interests. After that, there should be taken place the evaluation process whether to act in the interests of the foreign investor or to interfere the investment's actions.

Continental Casualty v. Argentina, the Investor claimed compensation for violations under fair and equitable treatment. Argentina was faced with an emergency situation, the social situation of the country was dreadful and Argentina was forced to change the economic plan of the country.[18] The Tribunal found that:

"states should be able to exercise their sovereignty in the interest of their population free from internal as well as external threats to their security and the maintenance of a peaceful domestic order"[19] , thus putting prior the host States right to regulate on the scope of the public interest and circumventing the Investors protection right under FET, as it found the public welfare is above the Investors' interest, as it was reasonable and grounded.

The world has started to develop new types of BITs that are mostly focused on monitoring cooperating and balancing process between investor and state. For instance, in 2015 Brazil has started to develop a new model of investment agreement treaty, replacing the consolidated notion of giving priority to the international investment protection with one based on investment cooperation and facilitation. The new approach stipulates 1) creating a new mechanism of monitoring and preventing investor-State dispute by a way of forming joint committees and by the help of an ombudspersons 2) creating open-ended or framework agreements that can be

[18] *Continental Casualty Company v. the Argentine Republic* (ICSID Case No. ARB/03/9)

[19] *Ibid.*

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adapted over time to accommodate the state parties' development needs through thematic work programs. [20] By this way, The Republic of Brazil tries to minimize the problems that may occur between State and foreign investor and neutralize the problem of which side to give a priority: foreign investment protection or State right to regulate. We think, in case of possible political changes this kind of BITs will provide proper protection for both State and investor, and be a mediator between State and foreign investor. Such kind of BITs will also help to minimize the risks of huge loss for both sides, according to its mechanisms of monitoring, preventing and mediating.

§ The legitimate expectations of the investors

Taking into account undeniable right of the State to regulate and express its sovereignty, it is also a necessity to enable foreign investors to plan their activities within the territory of the hosting state. However, political change is considered a situation which is not easy to foresee by the foreign investor. The legitimate expectation doctrine has its leading position in investment treaty jurisprudence. Foreign investor, while making an investment in a hosting state, is led by the situation at that time in that state. Therefore, he has legitimate expectation concerning a stable legal and political environment in the hosting country. The legitimate expectation is the most significant factor that motivates the foreign investor to make the decision of investing and, thereafter the way investment should be managed.

As Andrew Newcombe and Lluís Paradell note, legitimacy is manifested by the form of making reliance on the host state's conduct expressed by oral or written representations or commitments made by the host state relating to an investment.[21] Investors have a reasonable expectation that the host state will comply with its IIA obligations.[22]

[20] Marosini F., *Making the Right to Regulate in Investment Law and Policy Work for Development: Reflections from the South African and Brazilian experiences* (2018) *available at:* https://www.iisd.org/itn/2018/07/30/making-the-right-to-regulate-in-investment-law-and-policy-work-for-development-reflections-from-the-south-african-and-brazilian-experiences-fabio-morosini/

[21] Andrew Newcombe & Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Alphen aan den Rijn, Netherlands: Kluwer Law International, 2009) p. 280

[22] *Ibid.*

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In Andrew Newcombe and Lluís Paradell opinion reliance takes the form of making investments or expanding existing investment in that particular State. In this sense, the principle of legitimate expectation is connected to the estoppel principal and States responsibility for unilateral acts.[23]

Thus, we think that foreign investor always expects stable administrative framework. However, even if foreign investor does not exclude the possibility of political situation change, he always has a legitimate expectation that the new regime will not be interfering foreign investment or will act stable and transparent while acting or making a decision which will interfere the foreign investor's action. Expectations can rest on specific representations made by the host State to the investor by governmental officials.

However, there are cases when an investor could not obtain legitimate expectation protection. For instance, in *Bayindir* v. *Pakistan,* the Claimant suffered from political change a lot. According to the facts the changed prime minister gave assurances, based on which the investor made the investment. After the prime minister resigned, the new political regime changed his position toward foreign investment.

The Tribunal found that after the change of the Government the claimant could not argue legitimate expectation that the State would not exercise its right to terminate a construction agreement. Bayindir failed to convince the Tribunal that the new regime acted in bad faith.[24]

We think that it is always important to take into consideration the intent of the state's actions. If after the analysis of the state's action there is no intent found, then there operates a state's regulatory power. The breach of legitimate expectation is not only connected with the factor of contractual rights' breach, but also the guarantees given by the current or the previous regime.

Técnicas Medioambientales Tecmed, SA v Mexico case was the first to highlight investors' legitimate expectation doctrine's scope under the investment treaty law regime:

''The foreign investor expects the host State to act in a consistent manner, free from ambiguity and totally transparently in its relations with the foreign investor, so that it may know beforehand any and all rules and regulations that will govern its investments, as well as the

[23] *Ibid.*

[24] BAYINDIR INSAAT TURIZM TICARET VE SANAYI A.Ş. v. the ISLAMIC REPUBLIC OF PAKISTAN, ICSID Case No. ARB/03/29

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goals of the relevant policies and administrative practices or directives, to be able to plan its investment and comply with such regulations''[25].

In our opinion, in case of revolution or governmental changes, this regulation may not be effective, as the new regime establishes its conditions and its rules. Finally, the legitimate expectation doctrine is connected with the factor of public officials' decision to alter their policies. Nevertheless, it is worth to note that the freedom of public officials to change their policies is not absolute. The authorities must avoid acting in such a way that defeats the legitimate expectations of foreign investors without having certain weighty grounds justifying such actions. An application of legitimate expectation is not an absolute right, as it is restricted by the interest of public welfare.

[25] Andrew Newcombe & Lluís Paradell, *Law and Practice of Investment Treaties: Standards of Treatment* (Alphen aan den Rijn, Netherlands: Kluwer Law International, 2009) p. 284

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CHAPTER 2

PROTECTION OF INTERNATIONAL INVESTMENTS IN CASE OF POSSIBLE POLITICAL CHANGES

§Analyses of Protection standards under the UK-Armenia and Canada-Armenia BITs

In Armenia recently have occurred political changes and the state decided to reassume its right to regulate. In fact, the legislative regulation for the protection of investments in Armenia hasn't changed in any way for a long time. However, the state will on the other side has changed a lot. Previously in many cases, the state was resilient to implement a right to regulate for many different reasons, which might be corruption, personal interests of high-ranking governmental authorities disregarding the interests of public and state, etc. The recent political changes which occurred after the revolution, which have brought to perspectives different from the previous one. In this situation, the RA government has opted to care more about the public wish by protecting the public health, security and other public interests. This is the reason why public riots, discontent have raised to a higher level, and the state has a factual necessity to deal with such riots. In such circumstances, the state has come to reconsider its right to regulate and is ready to enforce it with new impetus.

In this restatement of the state's right to regulate it is utterly important for the investors to find the most effective means for protection both under the respective BIT with Armenia and the national law of Armenia. It is important to outline that no treaty provision provides an exception to its substantive provisions for conduct that takes place during or because of a transition in the form of Government within a state.[26] As such it is important to understand whether an incoming new regime or the conduct of the transitional regime breaches the right of the investors, thus breaching the treaty provisions.

There is a list of protection standards which is presented under UK-Armenia BIT. The BIT provides for the following protection standards:

- Fair and equitable treatment
- Full protection and security
- National treatment and Most-favored-nation treatment

[26] Stephan W. Schill, Christian J. Tams, *International Investment Law and Development: Bridging the Gap*, p. 294 (2015)

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- Compensation for expropriation and losses

The latter provisions are the core substantive provisions that might be applied in the claim in case of political changes.

In UK-Armenia BIT, we are going to analyze the protection standards provision by provision to understand whether a foreign investor has substantive protection in case of claims on political ground.

Article 2(2) Fair and equitable treatment (hereinafter: FET*)* assumes that:

"Investments of nationals or companies of each Contracting Party shall at all times be accorded fair and equitable treatment and shall enjoy full protection and security in the territory of the other Contracting Party. Neither Contracting Party shall in any way impair by unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal of investments in its territory of nationals or companies of the other Contracting Party…"[27]

The following article provides protection for foreign investors that prohibits unreasonable or discriminatory measures the management, maintenance, use, enjoyment or disposal of investments in its territory no matter under which regime the agreement was concluded. Thus, as a result of political changes, the successor regime, which is considered holder of all rights and obligations, must bear the obligation of treating foreign investor fair and equitable, non-discriminatory and unreasonably.

FET is considered the most significant protection standard for the foreign investor because it let the foreign investors challenge a broad range of Government conduct that affects their investment. [28]

FET is usually interpreted under the light of legitimate expectation doctrine and is an expression of bona fide principle. There is no definite and identical interpretation of this standard. The interpretation of FET is given by the Tribunals which are interpreting cases concerning FET protection standard stipulated by the treaties applicable to that particular case. Rudolf Dozer finds the FET standard as a principle of good faith and it involves broader meaning and is applied when the Claimant cannot bring litigation under expropriation claim.[29]

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[27] *For The Promotion And Protection of Investments*, UK-Armenia BIT, Treaty Series No. 102, (1996)

[28] Schill St., Tams J. Christian, *International Investment Law, and Development: Bridging the Gap*, p. 295

[29] Dolzer R., Schreuer Ch., *Principles of International Investment Law*, Oxford University Press (2012)

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To thoroughly understand FET standard under UK-Armenia BIT we should also analyze Energy Charter Treaty and the interpretation of UNCTAD. Article 10(1) of Energy Charter Treaty, it becomes obvious that the later put its emphasis on an equitable, favorable and transparent notion, continuing with the investors right of management, maintenance, use, enjoyment or disposal of non-impairment by unreasonable or discriminatory measures by the host State. Energy Charter Treaty does not directly regulate political change situation under FET standard also, as it gives a broader meaning of it, however, it also highlight the importance of investors right to manage, use, enjoy, maintain his investment during every political regime.

UNCTAD interpreted the FET standard by stating that it protects investors from the host State's arbitrary, discriminatory or abusive conduct. UNCTAD gave five main concepts of FET standard:

"(a) Prohibition of manifest arbitrariness in decision-making, that is, measures taken purely on the basis of prejudice or bias without a legitimate purpose or rational explanation.

This means that only the change of political regime does not manifest arbitrariness of decisions made by the successor government. The new regime may also have prejudice and bias attitude toward foreign investment, which is also prohibited under the FET standard.

(b) Prohibition of the denial of justice and disregard of the fundamental principles of due process;

The new regime isn't allowed to interfere in the process of justice using its levers of the FET standard and must pay attention to the fundamental principles of due process. This also applies to the revolution cases, as the new political power is also considered as a successor of the old regime with its rights and obligations.

(c) Prohibition of targeted discrimination on manifestly wrongful grounds, such as gender, race or religious belief;

Political change may bring with it prejudiced attitude, like targeted discrimination on certain grounds towards foreign investment. UNCTAD interpreted the FET standard in these aspects also.

(d) Prohibition of abusive treatment of investors, including coercion, duress, and harassment;

UNCTAD interpreted coercion, duress, and harassment of foreign investor under the FET standard. However, in our opinion coercion, duress and harassment go under full protection and security standard, as it is directly connected with an investor, not the investment.

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(e) Protection of the legitimate expectations of investors arising from a government's specific representations or investment inducing measures, although balanced with the host State's right to regulate in the public interest." [30]

Here UNCTAD interpreted one of the components of the FET standard-legitimate expectation. The legitimate expectation is arising from a government's specific representations. Thus, in case of political changes, there may not be an overlap of the viewpoint of the old and new regime. The investments that were based on statements of the government's specific representations may entail to the breach of foreign investor's legitimate expectation during the new regime.

A state has a right to invoke political changes to circumvent the investor's right of protection under the FET- the state has a right to protect, for instance, environment, public health, public security, etc. The investor's problem in such case is to prove the priority of its protection under the FET standard against the right of a state to regulate.

In *Técnicas Medioambientales Tecmed, SA v Mexico* case Mexican officials were behaving themselves contrary to fair and equitable treatment, lack of transparent, thus the renewal of the license for exploitation of the landfill by Spanish investor was refused, because of political changes and local protests. Hence, the Tribunal stated:

"The foreign investor also expects the host State to act consistently, i.e. without arbitrarily revoking any pre-existing decisions or permits issued by the State that were relied upon by the investor to assume its commitments as well as to plan and launch its commercial and business activities" [31] For this reason, the host State's conduct was qualified biased and ambiguity in spite of expectations created. This scenario is one of the examples that point out one of the significant results of political change situation- the change of the government's viewpoint.

The next protection standard which worth to discuss under UK-Armenia BIT is *full protection and security* standard. In many cases this right has also been recognized as more important than the state's right to regulate. This standard is stipulated in article 2(2) of UK-Armenia BIT and is presented with fair and equitable treatment standard that "Investments of

[30] UNCTAD, *Series on Issues in International Investment Agreements II*, xvi (2012)

[31] *Tecmed v. Mexico*, ICSID Case No. ARB(AF)/00/2, Award of 29 May 2003

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nationals or companies of each Contracting Party shall at all times… enjoy full protection and security in the territory of the other Contracting Party."[32]

To understand the concept of full protection and security we also learn NAFTA provision providing protection and security for foreign investments. In its article 1105 is stated: "Each Party shall accord to investments of investors of another Party treatment in accordance with international law… full protection and security."[33]

According to the Dozer full protection and security is understood as physical security and protection or legal protection of assets which has a connection with the foreign investment.[34]

In *Amco v Indonesia* the Tribunal stated that:

"*The State has a duty to protect aliens and their investment against unlawful acts committed by some of its citizens (...). If such acts are committed with the active assistance of state-organs a breach of international law occurs*"[35]

In *CME v Czech Republic*[36] the officials of the host State made a situation where the Czech partners of the Investors terminated the contract with the Investor, on which the investment was depended. The Tribunal made an argumentation: "the host State is obligated to ensure that neither by amendment of its laws nor by actions of its administrative bodies is the agreed and approved security and protection of the foreign investor's investment withdrawn or devalued."

Summing up full protection and security standard, we see that the host state's government and authorities are obliged not to only abstain from certain actions but also in some cases take actions to provide legal protections to investor's assets. This obligation is transferred to the new regime in case of political changes.

Bilateral Investment treaties contain provision referring to consequences of revolution, civil disturbance, political changes, and similar scenarios. In the British model of treaties, the protection of foreign investment under the mentioned circumstances is applied in the national treatment and most-favored-nation provisions. In case of national treatment and most-favored-nation, it is much more difficult for a state to prove its right to regulate. The state has to bring

[32] *For The Promotion And Protection of Investments*, UK-Armenia BIT, Treaty Series No. 102, (1996)

[33] North American Free Trade Agreement, art. 1105 (1994)

[34] Dolzer R., Schreuer Ch., *Principles of International Investment Law*, Oxford University Press (2012)

[35] *Amco Asia Corporation and others v. the Republic of Indonesia*, ICSID Case No. ARB/81/1

[36] *CME Czech Republic B.V. (The Netherlands) v The Czech Republic*

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reasons for discriminating between aliens and its nationals or other nationals in that specific case.

In UK-Armenia BIT national treatment and most-favored-nation (hereinafter: MFN) provision are stipulated in the same article, under article 3 is stated:

"Neither Contracting Party shall in its territory subject investments or returns of nationals or companies of the other Contracting Party to treatment less favorable than that which it accords to investments or returns of *its own nationals or companies* or to investments or returns of nationals or companies of *any third State*.

… as regards their management, maintenance, use, enjoyment or disposal of their investments, to treatment no less favorable than that which it accords to *its own nationals* or *companies of any third State."*[37]

To understand the notion of *national treatment* first we will analyze no "*less favorable than"* statement. The latter is that in like circumstance situation, the foreign investors should not be in low positions in a hosting state and the priority should not be given to local investors. In SD Myers v. Canada[38] case the Tribunal interpreted competitive relationship of two business activities which are operating in the same area. Thus, to constitute a rational ground for claim under the national treatment clause is the host state's national policies to act in favor of domestic public interest.

In Occidental v. Ecuador the Tribunal upheld that; "like circumstances" cannot be interpreted in the narrow sense advanced by Ecuador as the purpose of national treatment is to protect investors as compared to local producers, and this cannot be done by addressing exclusively the sector in which that particular activity is undertaken."

An investor is protected under national treatment provision, as a new government is prohibited by this provision also. A new regime is not allowed to treat a foreign investment as regards to its management, maintenance, use, enjoyment or disposal of their investments, to treatment less favorable than that which it accords to its own nationals or companies. Thus, this means that after political changes, the new regime cannot have highlighted attitude towards national investor and companies in like circumstances. The same principle is applied in MFN protection provision.

[37] *For The Promotion And Protection of Investments*, UK-Armenia BIT, Treaty Series No. 102, (1996)

[38] *S.D. Myers, Inc. v. Government of Canada*, UNCITRAL

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MFN standard is defined as treatment accorded by the granting host State to the beneficiary State or to persons or things in a determined relationship with that state, not less favorable than it would be granted by the hosting State to a third State or to persons or things in the same relationship with that third state. The MFN clause to be considered as breached the less favorable treatment should fall under the same category of treatment as the one granted to the third state, thing, person, which in their turn are limited in the base of the claim by being in the same category as those entitled to the treatment being claimed (the third state/thing/person).

From our perspective, the principle of the two standards is similar- there should be discriminative and less favorable treatment towards the foreign State's investments by way of giving the priority to the other third State's investments or the host State's local investments.

In *Parkerings v. Lithuania*, the claimant urged that the Dutch company was given more opportunities and there was a difference in treatment contrary to the MFN clause. The Tribunal confirmed that the two companies had a similar condition of application for the tender, however, the Dutch company was chosen, being the subject of indirect advantage. In accordance with the Tribunal:

"Discrimination involves… issues of fact where a State unduly treats differently investors who are in similar circumstances. Discrimination must be unreasonable or lacking proportionality, for instance, it must be inapposite or excessive to achieve an otherwise legitimate objective of the State. An objective justification may justify differentiated treatments of similar cases. It would be necessary, in each case, to evaluate the exact circumstances and the context".[39]

After the revolution and political changes, there may take place retaliation against investors who cooperated with the overthrown regime. The new regime may revise all the agreements that were concluded with the previous regime, as it may consider the contracts were obtained through corruption and against public interests. In fact, there may take place the following measures: retaliation expressed by confiscation of assets, the appointment of new persons to control the project, the prohibition to control the investment and the deprivation running the companies.

The next protection standard stipulated in UK-Armenia BIT is expropriation.

In article 5(1) it is stated:

[39] *Parkerings-Compagniet AS v. the Republic of Lithuania*, ICSID Case No. ARB/05/8

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"Investments of nationals or companies of either Contracting Party shall not be nationalized, expropriated or subjected to measures having effect equivalent to nationalization or expropriation (hereinafter referred to as "expropriation") in the territory of the other Contracting Party except for a public purpose related to the internal needs of that Party on a non-discriminatory basis and against prompt, adequate and effective compensation..."

Expropriation is taking of an investment by a government of a hosting state. It is the most commonly measures which is taken after the revolutions or political changes by the new regime. The effect of the political transition is expressed by measures taken by the successor Government against foreign investors, which contracted with the previous regime. Expropriation may take place for both tangible and intangible assets. In case the new regime tries to invalidate old agreements of the foreign investments, investors should turn to the protection of international investment agreements to save their investments. Whenever the state acts as a party of the contract and it does not use its sovereign powers than the action would not be qualified as expropriation.

There exist four ways that confirm the legality of the expropriation measures. First, the measure that may be undertaken, should serve for public purpose; second, measures must not be arbitrary or discriminatory; third, after the expropriatory measures foreign investor must be compensated promptly, adequately, effectively and equivalent to fair market value; fourth, some treaties require that the process of expropriation must follow FET standard. [40]

There are two ways of expropriation direct (de jure) and indirect (de facto). In case of direct expropriation, the hosting state nationalizes foreign-owned investments. Indirect expropriation is characterized as depriving the investment to be used in a meaningful way, without touching the investor's legal title.[41]

In indirect expropriation cases, tribunals should refer to proportionality analysis. [42] There is no clear definition of acts that would qualify the expropriation actions.

In S.D. Myers v Canada the tribunal stated that both the purpose and the effect of the measure should be taken into account, and remarked elsewhere in its decision that authorities enacting a

[40] Dolzer R., Schreuer Ch., *Principles of International Investment Law*, Oxford University Press (2012), p. 98

[41] *Ibid.,* p. 101

[42] Henckles C., *INDIRECT EXPROPRIATION AND THE RIGHT TO REGULATE: REVISITING PROPORTIONALITY ANALYSIS AND THE STANDARD OF REVIEW IN INVESTOR-STATE ARBITRATION;* Journal of International Economic Law 15(1), Oxford University Press 2012, p. 230

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measure impacting on foreign investment were required to select a measure that had the least restrictive effect on that investment, citing WTO case law in support of its approach.[43]

All tribunals agree that actions of the state taken of good faith, the purpose of which is protecting public health, environment, etc. is not considered expropriation. Thus, there are cases when regulatory measures should not be qualified as expropriation. Not every measure that affects the economic value of the investment or its profitability amounts to expropriation. Hence, one of the most important things to take into account is the intent of the hosting state-why it is doing an expropriation.

The analysis of the Canada-Armenia BIT in the scope of investor protection standards is also presented to find whether it also provides foreign protection in case of possible political changes. We understand that as the UK-Armenia BIT Canada-Armenia BIT also provides the same protection provisions, such as fair and equitable treatment, full protection and security, most-favored-nation treatment, national treatment, expropriation.

1. The UK-Armenia BIT stipulates the obligation of a state to admit the capital of the investor from another contracting state unless it contradicts its laws. Of course, this obligation can also be derived from the obligation to encourage favorable conditions to invest, however, the UK-Armenia BIT, in fact, creates a much stronger possibility for foreign investments.

   In Canada-Armenia BIT the possibility for establishing a new business enterprise or acquiring an existing business enterprise is provided on the basis of national treatment and most-favored-nation provision. But the abovementioned two provisions are totally different and provide protection to different categories. The first one refers to the possibility to import capital to another state, and the other to merely the possibility of technical establishment or acquisition of an enterprise.

2. FET and full protection and security are one of the main standards stipulated in both the UK-Armenia and Canada-Armenia BIT. It is worth to note that in Canada-Armenia BIT not only the investments but also the returns from the investments enjoy these protection standards.

3. National treatment and most-favored-nation provisions in the Canada-Armenia BIT provide for a few exceptions unlike to the UK- Armenia BIT, which grants the same

[43] *Ibid.,* p. 230

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protection to any kind of business. Such exceptions are, for example, aviation, telecommunication, transport, financial services, etc. Besides, the Canada- Armenia BIT specifically grants the same treatment also to investment after its establishment, namely in respect of expansion, management, conduct, operation sale disposition.

4. The Canada-Armenia BIT goes further in this respect and restricts the rights of the contracting states to interfere in the businesses of the investors, like require the appointment of specific nationalities for the senior positions, or to achieve a certain level of the export or domestic content, etc.

In light of the mentioned differences, it is obvious that in many cases the Canada-Armenia BIT provides much wider protection to investors, at the same time limiting the rights of the state. Such scope of protection is quite a good security for investors in case of any possible political changes.

Bilateral investment treaties contain provisions that refer to the situation of armed conflict, insurrection, civil disturbance, state of emergency, revolution, or similar events. In the presence of one of the circumstances listed above State must grant compensation to an investor. Compensation standards identical to those provided for expropriations.

Two categories of clauses must be distinguished. The first type of clause, which is stipulated in Canada-Armenia BIT obliges the State to compensate a foreign investor because of these events in accordance with the standards of national treatment and treatment of the most favored nation. The second category can be found in UK-Armenia BITs. It is similar to the first as it grants national treatment and MFN treatment in case of damage that resulted from one of the events listed above.

Still, the clauses differ in that they require more than MFN and national treatment if the investment has been requisitioned or destroyed by the forces or authorities of the host State when this requisition or destruction was not required by the necessities of circumstance.[44] Canada-Armenia BIT does not have any regulation referring to the necessity of the situation. The latter gives compensation not restricting cases when the compensation must be done.

[44] Schill St., Tams J. Christian*, International Investment Law, and Development: Bridging the Gap*, p.311

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§ Protection of foreign investments after the recent Governmental changes in Armenia: case analysis of Lydian v. Armenia

After the changes of the political regime, revolution or governmental changes, the effect of the political transition is expressed by measures taken by the successor Government against foreign investors, which contracted with the previous regime. Often, the new rulers revoke or modify the contract concluded by former rulers on the ground that such contracts have been obtained through corruption or are incompatible with the public interest.[45] In Lydian Armenia case the public officials also has a suspicion that the license for exploitation of the mine was not obtained by lawful ways.

One of the famous similar scenarios took place in Egypt in 2011. After the uprising by Mubarak, the activists and lawyer raise the question concerning the contracts between foreign investors and the former Government. They asserted that public companies were sold very cheaply by a representative participant in corrupt business practices. Currently, Libya is also dealing with contracts with foreign investors that were concluded before 2011. [46] However, if the new regime decides to revoke old agreements, foreign investors have a chance to have recourse in an arbitral way offered in international investment treaties and local investments laws to have a protection of their rights.[47]A foreign investor has an opportunity to claim that a cease of the contract is an unfair, unjust and arbitrary treatment, expropriation, and breach of umbrella clause.

A contract which was signed during the undemocratic regime is protected under BIT unless the investment contract is not signed with the breach of host State domestic law.

Lydian Armenia CJSC is a company, which is doing mineral exploration and development. In 2014 Lydian got environmental permission and right to do mining in Amulsar, which is situated in the region of Vayots Dzor and Syunik. [48] However, in 2018 June, after the governmental changes in Armenia, the activists being inspired of later occasions, started a protest process to prevent the exploitation of Amulsar mine, claiming that it will entail to spoiling the water and environment, a threat for the brand Jermuk. According to the decision of

[45] *Ibid.,* p. 312
[46] *Ibid.*
[47] *Ibid.*
[48] *Available at*: https://www.lydianarmenia.am/index.php?m=pages&lang=eng&p=67

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the RA investigation committee, "Elard" international expertise company will carry out a comprehensive expertize concerning the exploitation of Amulsar gold mine.[49]

In the scope of the topic, we will analyze the possible form of protection of both sides. In the scope of foreign investor's protection, it is worth to discuss standards, such as fair and equitable treatment, full security and protection, indirect expropriation. For the Republic of Armenia, defenses are the following- state's right to regulate and state of necessity doctrines. By concluding the international agreements, Armenia confers on foreign investors the right to regain their losses through investment treaty arbitration *i.e.,* a direct route to neutral dispute resolution, and thus depoliticizes the process of resolving international investment disputes.

As the Lydian investors are Anglo-American investors, the case can be claimed under the UK-Armenia BIT. As we have already discussed above, FET standard denies arbitrariness in the decision-making process by the host state; targeted discretion towards the investment, breach of investor's legitimate expectation connected with measures taken by the host state, the denial of justice. This provision makes obvious that Armenia should take all the necessary measures for the foreign investment to thrive and exist. At the same time Armenia is forbidden from taking unreasonable steps and harm foreign investors and investments. On the other hand, State has a right to regulate for public interests and is able to exercise its sovereignty for the interest of its population, thus putting prior the host States right to regulate and circumventing the investors' protection rights under FET. If the results of the expertize will confirm the existence of the threat to the locals' waters and their health, the RA Government will be obliged to make regulation over the investment.

The next protection standard which may be invoked in the case is full protection and security standard stipulated in UK-Armenia BIT. The latter stipulates that Armenia has an obligation to protect the Lydian investment from actions of public officials, demonstrators, and activists. Another protection under which Lydian investors may find protection is expropriation. It is undeniable that a state has power and the right to expropriate the investors' property. However, there are certain conditions, which are an absence of discrimination, strict existence of public interest, the prompt, adequate, effective process of compensation, which must be kept while doing an expropriation.

[49] *Available at*: https://www.ecolur.org/hy/news/amulsar/---/11002/

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If the host State decides to expropriate than its steps should be proportional and balanced on purpose and effect.[50]

In the side of the RA, there are certain possible defenses, first, public police doctrine, which enable the State to intervene Amulsar mine investment, interrupt its exploitation for the purposes of protecting environment and regional water, in case the expertizing organ confirms the dangerous consequences of the exploitation. This means that the State's Government will be able to take certain regulatory measures. There is practice in courts not to define all indirect expropriations as compensable if its stems of police power nature. In *Methanex v. the USA*, the tribunal denied the indirect expropriation confirming the measures as having a ground of bona fide and designed to serve a public interest.[51] Latter stated:

"as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alia, a foreign investor or investment", continuing with: "from the standpoint of international law, the California ban was a lawful regulation and not an expropriation". [52] Thus, the taken measures cannot be considered indirect expropriations, regardless of any adverse effects on the investment.

So, according to certain practices the RA cannot bear responsibility for "... *loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory and is not designed to cause the alien to abandon the property or sell it at a distress price."*[53]

The next way to find protection against investors claim by the RA Government is a state of necessity doctrine. The necessity doctrine serves as a legal ground for balancing investors' interests with State's actors' interest.[54] Necessity provision provides State actors the possibility

[50] Henckles C., *INDIRECT EXPROPRIATION AND THE RIGHT TO REGULATE: REVISITING PROPORTIONALITY ANALYSIS AND THE STANDARD OF REVIEW IN INVESTOR-STATE ARBITRATION;* Journal of International Economic Law 15(1), Oxford University Press 2012, p. 230

[51] Nikièma S., *Best Practices Indirect Expropriation*, The International Institute for Sustainable Development (2012) p. 17

[52] *Ibid.*

[53] "*Indirect Expropriation" and the "Right to Regulate" in International Investment Law*" (OECD Publishing 2004/04), OECD Working Papers on International Investment <http://dx.doi.org/10.1787/780155872321> accessed 20 January 2017, citing "Restatement of the Law Third, the Foreign Relations of the United States," American Law Institute, Volume 1, 1987, Section 712.

[54] Galvez C., "*Necessity," Investor Rights, and State Sovereignty for NAFTA Investment Arbitration*, (2013), p. 147

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to avoid the negative consequences, nevertheless breaching obligations in some circumstances.[55] A state may not present a necessity argument for violating an international obligation unless it acted in the possible only way to safeguard an "essential interest against a grave and imminent peril".[56] The other doctrine which may be referred by the Government is a clean hands doctrine, which presents itself idea of investment protection only in those circumstances when investor acted in accordance with the law. In *Gustav F W Hamester GmbH & Co KG v. Ghana Tribunal stated that: "*An investment will not be protected if it has been created in violation of national or international principles of good faith; by way of corruption, fraud, or unlawful conduct; or if its creation itself constitutes abuse of the international investment protection system under the ICSID Convention. It will not also be protected if it was made in violation of the host State's law.*"* Thus, if the investigation organ of The RA proved the existence of the corruption by Lydian investors to get the license for exploitation of the mine, there may not stay any possible way to find protection under BIT by its investors.

[55] *Ibid.,* p. 148
[56] *Ibid., p. 146*

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CHAPTER 3

DO THE ARMENIAN BITs PROVIDE PROPER PROTECTION FOR FOREIGN INVESTMENTS IN THE SCOPE OF POSSIBLE POLITICAL CHANGES?

There exists an effective model of protection provided in the intergovernmental level, which is considered a productive method of minimizing the level of political risk. There are certain standards of protection provided in the BITs discussed above in this paper that mitigate political risks for foreign investments. Nevertheless, it is undeniable that before investing in Armenia the big investors always assess the political risk and its possible threat to their investment. Some investors dare to invest, while there exists an appreciable group of investors that is skeptical to make an investment in Armenia proceeding the recent political changes.

As political changes are in fact highly unpredictable for the investors while making their investment and becoming vulnerable in front of the Government, the UK-Armenia BIT and the Canada-Armenia BIT provide for a quite broad FET protection standard. The FET standard prohibits the transitional Government to alter the investment contract unilaterally or to change the local laws which govern the foreign investment, making the Government liable in front of the foreign investor under and according to the bilateral investment treaties. Thus, the FET standard is considered to be a solid assurance for the investor to be protected from unpredictable legislation changes, which govern the relationship stemming from his investment. It also allows the owner of the foreign investment to challenge a huge amount of Government conduct.

According to the (court) decision made in the case Frontier Petroleum v. the Czech Republic "The investor may rely on that legal framework as well as on representations and undertakings made by the host state including those in legislation, treaties, decrees, licenses, and contracts."

This means that under the FET standard the investor is protected from the unilateral changes in contracts and legal acts by the host Government which might entail changes in the conditions of the foreign investment.

What concerns to expropriation institute, the UK-Armenia BIT and the Canada-Armenia BIT both stipulate for adequate and prompt compensation to be made to the investor. However, it is not a secret that political change is a hard situation, and the newly changed Government, even being the successor of the old regime, can push forward solid argumentations concerning public health and the prevailing public interest as it happened in Lydian case. Nevertheless, it is undeniable that all rights and obligations of the previous Government shall be transferred to the

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new regime in their entirety. It will be quite hard for the new Government to deny its obligation, which stemmed from the agreement made between the old regime and the investor. The international law's lever is that the new regime is bound by the same legal obligations that were bound by its predecessors. According to VCLT article 62:

A fundamental change of circumstances which has occurred with regard to those existing at the time of the conclusion of a treaty, and which was not foreseen by the parties, may not be invoked as a ground for terminating or withdrawing from the treaty unless:

(a) the existence of those circumstances constituted an essential basis of the consent of the parties to be bound by the treaty; and

(b) the effect of the change is radically to transform the extent of obligations still to be performed under the treaty.

Thus, if a political change is considered to be a fundamental change, there is a possibility that the new regime might argue that the change in the Government is serving a solid ground for terminating or withdrawing from the treaty and that it satisfies these criteria. However, it is quite difficult to prove that by the alteration of the Government will radically transform the extent of obligations to be performed.

From both BITs, we can also conclude that the compensation by Government should be based on the genuine market value of the investment. We think that in this case, the rule is insufficient. The regulation should firstly provide for exploring the circumstances in which the investment was acquired and then discuss the fair market value compensation.

The main threat to foreign investment in case of possible political changes is the possible argumentation of public interest by the transitional Government, pushing the old regime’s indifference towards the political interest while letting the foreign investment in its country.

However, the BITs do not have any lever which would allow the changed Government to inhibit the action of foreign investment as it happened in Lydian case. This can also be considered indirect expropriation. The BIT does not also provide means that would prohibit the new regime from taking under suspicion all the agreements made between the old regime and the foreign investor, and put under the threat the investment protection pushing corruption and public interest argumentation.

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We can see that in both BITs there is no provision alluding about the consequences of illegal acts of the host State on foreign investments. We consider that it cannot entirely be involved in the expropriation institute. However, it can also be considered as a breach of the treaty.

Case concerning Certain German Interests in Polish Upper Silesia also responds to this question: "Reparation must, as far as possible, wipe out all the consequences of the illegal act and re-establish the situation which would, in all probability, have existed if that act had not been committed."[57]

There is also no mentioning about political regime changes in both BITs. Thus we understand that no matter whether the agreement was concluded under an authoritarian or a democratic regime, the foreign investor finds protection under the BITs. However, the RA should develop its BIT model to clearly frame the level of protection that it grants to foreign investors and balance it with its regulatory autonomy.

[57]Lee, K., ICSID reports, Cambridge University Press, (2007)

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CONCLUSION

Analysis of the UK-Armenia and Canada-Armenia BITs shows that there is no clear regulation of foreign investment's protection in case of possible political changes.

However, a list of protection standards is in place that provides protection for foreign investment, no matter under which political regime the agreement was concluded. In case of political changes the new regime is a successor of the previous Government. This means that it bears all the rights and obligations that are stipulated under the BITs. Therefore, the new Government, no matter whether it came to the power by revolutionary, electoral or other ways, has an obligation of protection, including compensation to the investor stipulated under the respective BIT.

On the other hand, if as a result of a revision of the agreements concluded during the previous regime, the newly came Government clarifies that those agreements were concluded by means of corruption or other unlawful ways, the new Government will have all rights to cease such agreements. It will also not bear an obligation to compensate those foreign investors.

Thus, the Republic of Armenia should develop its BIT model to clearly frame the level of protection that it grants to foreign investors and balance it with its regulatory autonomy.

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